

STATE OF HAWAII

Accounting Manual

Volume I

Part 400: General Nature of the Accounting System

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SECTION 483: DEPARTMENTAL INTERNAL CONTROL SYSTEMS

1. General. This section pertains to Section 40-2, HRS, which charges departments and agencies with the responsibility to maintain an adequate system of internal control and with the further responsibility to see that the internal control continues to function effectively as designed.
2. Definition. Internal control is described as follows in the AICPA publication on Statement on Auditing Standards:
 - (a) Administrative control includes, but is not limited to, the plan of organization and the procedures and records that are concerned with the decision processes leading to management's authorization of transactions. Such authorization is a management function directly associated with the responsibility for achieving the objectives of the organization and is the starting point for establishing accounting control of transactions.
 - (b) Accounting control comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:
 - (1) Transactions are executed in accordance with management's general or specific authorization.
 - (2) Transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and to maintain accountability for assets.
 - (3) Access to assets is permitted only in accordance with management's authorization.
 - (4) The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.
3. Responsibility. Section 40-2, HRS, defines the departments' and agencies' broad responsibilities in the area of internal control.
 - (a) Executive Branch. The departments and agencies of the Executive Branch are individually responsible for maintaining an adequate system of internal control and for assuring that the internal control system continues to function effectively as designed.

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- (b) Judiciary and Legislative Branches. The Judiciary and Legislative Branches are responsible for the establishment and maintenance of their respective internal control systems.

4. Internal Control.

- (a) Objective. The objective of internal control is to provide reasonable, but not absolute, assurances as to the safeguarding of assets against loss from unauthorized use or disposition and as to the reliability of financial reports for preparing financial statements and maintaining accountability for assets.
- (b) Cost-Benefit. The cost of a system of internal control should not exceed the benefits derived. Since precise measurements of costs and benefits usually are not possible, any evaluation of the cost-benefit relationship should recognize that estimates and judgments by management are necessarily required.
- (c) Limitations. There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal control.
- (1) Errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors.
 - (2) Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion.
 - (3) Control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements.
 - (4) Projection of any evaluation of internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

5. Required Features. Any system of internal control should include, as a minimum, the following elements:

- (a) Systems of authorizations, approvals, and recording procedures adequate to provide reasonable accounting control over assets, liabilities, revenues, and expenditures.

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- (b) Separation of duties concerned with record keeping and accounting reports from those concerned with operations or asset custody.
- (c) Physical controls over assets.
- (d) Personnel whose qualifications are commensurate with their responsibilities and duties.
- (e) Continuing internal review by management to determine:
 - (1) Prescribed policies, rules, and regulations are being carried out.
 - (2) Changes in operations have not made the procedures inefficient or obsolete.
 - (3) Effective corrective measures are being taken promptly when deficiencies are discovered.

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